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IN THE

Supreme Court of the United States

October Term, 1956.
No. 468

GEORGE R. CARR,

Petitioner,

vs.

BEVERLY HILLS CORPORATION, a corporation; JOHN P. LORDAN, MAYNARD BRANDSMA, FRANCIS E. BROWNE, ROBERT W. LANGLEY, HARRY F. DIETRICH, and ROSS J. FERRAR,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief of Respondents John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich and Ross J. Ferrar in Opposition to Petition for Writ of Certiorari.

Petitioner's statement of Questions Presented: (1) begs the question by assuming that jurisdiction of the District Court was "properly invoked" in the first instance and was "destroyed" by that Court in realigning the Corporation as a plaintiff, (2) incorrectly states that the Corporation "unites" with the other defendants in resisting plaintiff, and (3) incorrectly suggests that "a demand had been made to bring suit." (Pet. p. 2.) Hence, the individual respondents herewith set forth their own statement of the Questions Presented as is permitted by Rule 40(3) of this Court.

Questions Presented.

(1) Whether the Court below was in error in affirming the judgment of the District Court that it lacked diversity jurisdiction to hear a stockholder's derivative suit, where (a) the Corporation is admittedly the real party in interest and the party for whose benefit the action was brought, (b) the Corporation is a citizen of the same State as all individual defendants, and (c) the District Court found that at the time of and for at least five weeks prior to the commencement of the action, the Corporation had an independent Board of Directors, was not controlled by all or any of the individual defendants, and was not incapacitated in any way from filing the suit itself or from otherwise protecting its own financial interest; and

(2) Whether, in any event, this Court should afford its facilities to petitioner when it appears that the action is sham, frivolous and vexatious.

Statutes Involved.

In addition to the statutes and rules referred to by petitioner, we also consider that Rule 12(h) and Rule 52(a) of the Federal Rules of Civil Procedure (Appendix A hereto) are pertinent.

Statement of the Case.

Petitioner's statement of the case is devoted almost entirely to what he deems to be the merits of his charges (on behalf of the respondent Corporation) against the individual respondents and he thus fails to set forth most of the facts which are really determinative of the jurisdictional issue involved. This deficiency in petitioner's statement is due to his failure to differentiate between (1) facts material to the question of the merits of the alleged claims

of the respondent Corporation against the individual respondents, a question not passed upon below [R. 272], and (2) facts material to the question of whether petitioner had a right to bring a derivative action in the first instance and thus to designate the respondent Corporation as a true defendant and create diversity where none would exist if the Corporation had brought the action on its own behalf.

All of petitioner's charges against the individual respondents were specifically denied in the Court below [R. 90-97, 101-120, 223-241], but the details of such denials and attendant explanations need not be here set forth because, as noted, they were not passed upon below and are not relevant to the question of jurisdiction. For the same reason, we will not go into the details of the partnership known as the Beverly Hills Clinic (hereinafter referred to as the "Clinic") or its relations with the respondent Corporation (hereinafter referred to as the "Corporation") because they likewise are wholly irrelevant to the jurisdictional issue.

In June 1950 the petitioner purchased 400 shares of common stock of the Corporation [R. 265], and he was such a stockholder at the commencement of the action. His holding represents 1.6% of the total outstanding shares and cost him $400 [R. 234, 265]. At all of the times mentioned in the Complaint, petitioner's son-in-law, one Dr. Omar Fareed, was also a small stockholder as well as a partner in the Clinic [R. 116-117]. Donald A. Fareed, a brother of Dr. Fareed, was likewise a small stockholder [R. 226], and acted as attorney for and secretary of the Corporation from December 6, 1950 to December 4, 1952 [R. 116, 225] during which time he advised the Corporation concerning all of the alleged transactions now complained

of, with the single exception of the matter alleged in the third cause of action of the Complaint [R. 117].

The two Fareed brothers were fully informed of all matters relating to the Corporation and communicated at length with petitioner concerning those matters throughout the periods described in the Complaint [R. 221, 234, 235]. The true facts concerning the transactions now complained of were never concealed and such of the transactions as actually occurred took place with the full knowledge or means of knowledge, and acquiescence of all stockholders [R. 118].

No objection to any of the corporate transactions was made by any stockholder until December of 1952, when one of petitioner's counsel made certain objections and requested certain information from the officers of the Corporation [R. 118, 122]. In response to this request, all of the Corporation's books and records were promptly (on December 3, 1952) made available to petitioner's counsel, but he refused to examine or inspect said books and records [R. 122]. The following day (December 4, 1952) Donald A. Fareed resigned as counsel and the law firm of Gibson, Dunn & Crutcher was retained by the Corporation [R. 116, 142].

Between early December 1952 and the latter part of April 1953 the new counsel for the Corporation made available to petitioner's counsel for examination and copying numerous documents and papers of the Corporation [R. 126-129, 132-134] and arranged to have the firm of Haskins & Sells, certified public accountants, make a complete audit of all transactions between the Corporation and the Clinic [R. 129-131]. This was promptly done, and a copy of the audit report was furnished to petitioner's counsel on April 18, 1953 [R. 137-138].

In the meantime, on March 25, 1953, four new members of the five-man Board of Directors of the Corporation were elected, replacing on that Board the individual respondents Brandsma, Browne, Langley, and Dietrich [R. 90, 94, 101, 110, 134, 135]. None of the new Board members was a stockholder of the Corporation or a partner in the Clinic, and each was a well-known businessman and civic leader [R. 48, 51, 53, 134, 135, 182]. Petitioner's counsel was immediately notified of the names of the new Board members and was informed, in writing, on March 25, 1953 that "If after your study of the whole matter, there are any possible corporate claims which you think should be given attention, there is now an independent Board of Directors of the Corporation which will be available to give careful consideration to any matters when submitted by you" [R. 136-137]. No claims of any kind were ever made or submitted by petitioner or his counsel to the new Board of Directors [R. 48, 51, 55, 182].

On April 30, 1953 (some 36 days after being notified of the election of the new Board of Directors and 12 days after being furnished the special Haskins and Sells' audit), petitioner delivered to respondent Ferrar a copy of the Complaint herein, to which was attached a letter addressed to the Board of Directors stating that "George R. Carr [the petitioner] is filing the attached complaint with the United States District Court for the Southern District of California" and demanding that the Corporation "join him in prosecuting the civil action he is bringing against" the individual respondents [R. 44, 45, 98, 99].

The Corporation's counsel advised petitioner's counsel that he would call a meeting of the Board of Directors as soon as possible that afternoon to consider the claims of petitioner, but petitioner's counsel replied that the com-

plaint would be filed that day regardless of action by the Board of Directors [R. 99, 100] and the action was in fact filed that same afternoon.

On May 4, 1953, the complaint and claims of petitioner were brought to the attention of the new Board of Directors of the Corporation and upon the suggestion of Gibson, Dunn, and Crutcher that the Corporation might desire to secure new legal counsel, the new Board selected and retained the law firm of Latham and Watkins to represent the Corporation [R. 56, 142], and said last-mentioned law firm has represented the Corporation at all times since.

The new Board of Directors of the Corporation immediately began, through its new counsel, a complete and independent investigation of the facts and law involved in the claims set forth in petitioner's complaint, which investigation covered a period of four or five weeks [R. 56-58]. During the investigation, counsel for the Corporation repeatedly asked petitioner's counsel for any information which he had to support his charges, but none was furnished [R. 82, 83-85, 86-87].

A conference was finally held between counsel for petitioner and the Corporation on July 10, 1953 [R. 76], at which time, the Corporation's counsel reported results of his investigation and his tentative conclusions and again requested petitioner for information or proof to support his claims [R. 76, 192, 193]. Except for matters of minor importance, petitioner's counsel did not then furnish any of the requested information and never has furnished the same [R. 76, 197].

Meanwhile, on June 24, 1953, the new Board of Directors of the Corporation had a special meeting to receive and consider its counsel's report of its investigation of petitioner's claims [R. 58]. After thorough analysis

and discussion of each of the claims, the Board of Directors (except respondent Lordan who did not participate in the discussion and did not vote) adopted a resolution to the general effect that since the claims of petitioner were not supported by the facts and the prosecution of petitioner's claims would not be in the best interests of the Corporation, the Corporation should not join in or prosecute the action instituted by the petitioner, but should take whatever steps were necessary and possible to terminate the litigation with the least possible expense to the Corporation [R. 63-73].

The four new members of the Board of Directors (*i.e.* Messrs. Burnaby, Denny, Clark and Burden) are not charged with having anything to do with the alleged transactions complained of by the petitioner; and there has been no attempt by any individual respondent or anyone else to influence the new Board of Directors in the exercise of that Board's judgment and discretion [R. 49, 52, 57, 58, 183].

The Corporation is in the process of a voluntary wind-up and dissolution upon the written consent of over 90% of its stockholders [R. 128]. The assets of the Corporation have been sold at a profit [R. 127, 128, 141]. From the proceeds of such sale, all stockholders (including the petitioner) have been repaid the full amount of their loans, plus interest, and it is anticipated that at the completion of the dissolution, the Corporation will return to its stockholders the full purchase price paid for its stock plus a profit of about 75% of the purchase price, unless the cash remaining for distribution is dissipated in the costs and expense of this litigation [R. 141].

The Complaint herein is filed "on behalf" of the Corporation [R. 2] and prays for a money judgment in favor

of the Corporation [R. 25, 26]. Hence it is clear that the action is a derivative action and that the Corporation is the real party in interest and an indispensable party [R. 265]. Although petitioner affirmatively pleaded the fact that four of the five members of the Board of Directors were replaced by new personnel on March 25, 1953 [R. 11], which was more than five weeks prior to the commencement of the action, the Complaint also admits that no demand was made that the Corporation take action and the Complaint does not allege that the new Board of Directors has acted improperly in any way, or that it refused to bring the action, or that it abused its discretion in not bringing or maintaining the action.

None of the majority of the present Board of Directors of the Corporation is or has been under the domination or control of any of the individual respondents or of anyone who has been antagonistic or hostile to the financial interests of the Corporation [R. 49, 51, 52, 57, 92, 96, 103, 108, 112, 119, 183, 267, 268] and the Corporation was not, at the time of the commencement of the action, incapacitated from bringing or maintaining suit upon any cause of action which might exist in its favor or from protecting its own financial interests [R. 268].

Under all of the circumstances, the District Court ruled that although designated as a defendant by the petitioner, the Corporation must be aligned as a plaintiff for the purpose of determining whether the necessary diversity existed [R. 268]. The result of such realignment was that the requisite diversity of citizenship did not exist and, accordingly, the Court dismissed the action for lack of jurisdiction [R. 269, 272].

The United States Court of Appeals for the Ninth Circuit affirmed the judgment of the District Court.

ARGUMENT.

Petitioner inaccurately and unfairly criticizes the trial court when he refers to the "subterfuge of 'trial by affidavit'" [Pet. p. 13]. The fact is that at the hearing of this matter, the trial court advised counsel "that the court would also receive additional affidavits *and oral evidence*" if counsel desired to offer it [R. 264, 271], but petitioner offered none.

Petitioner is also inconsistent in his criticism of the Court below. For example, on page 12, petitioner states that the dismissal was "apparently for non-compliance with Rule 23(b)," while on the following page 13 he asserts "the rulings below were in no way based upon an alleged failure of petitioner to comply with the requirements of Rule 23(b)." Nevertheless, we believe it is his position that because he *alleged* diversity, the Court below was powerless to do anything about it.

In other words, it seems to be petitioner's position that his suit was "in classical compliance with Rule 23(b)" [Pet. p. 12] and that "Absent collusion, the instant *complaint* was one which clearly conferred jurisdiction in the District Court" [Pet. p. 13] and hence, that the trial Court could not look behind the complaint to get at the actual facts.

In making such argument, petitioner is wholly mistaken, as will appear from our brief analysis of the cases cited by petitioner [Pet. pp. 10-11] as well as certain authorities which actually control this situation.

I.

The Decision Herein Is Completely in Accord With Prior Decisions of This Court Announcing the Rule That in Determining the Question of Diversity Jurisdiction, the Mere Form of the Pleading May Be Disregarded and the Parties Aligned in Their True Position According to the Facts.

Plaintiff first argues that in realigning the parties "where proper *diversity* had been *alleged,*" the courts below "departed from established legal precedent" [Pet. p. 10]. Petitioner could hardly be more incorrect in this assertion, in view of the prior decisions of this Court announcing the rule that in determining jurisdiction, the courts are *not* bound by the pleadings. See for example the following four decisions wherein the Court looked beyond the pleadings, realigned the parties according to their real interests and dismissed for lack of diversity jurisdiction:

Hamer v. New York Railways Co. (1917), 244 U. S. 266, 61 L. Ed. 1125;

Niles-Bement-Pond Co. v. Iron Moulders Union (1920), 254 U. S. 77, 81-82, 65 L. Ed. 145, 148;

Lee v. Lehigh Valley Coal Co. (1925), 276 U. S. 542, 543, 69 L. Ed. 782, 783;

City of Indianapolis v. Chase National Bank (1941), 314 U. S. 63, 86 L. Ed. 47.

The foregoing rule in diversity cases is paralleled by other decisions of this Court holding that the mere allegation that the proper jurisdictional amount is involved is not controlling and approving a dismissal of the action

where facts dehors the complaint show that the jurisdictional amount is not in fact involved.

Paul V. McNutt v. Gen. Motors Acceptance Corp. (1935), 298 U. S. 178, 80 L. Ed. 1135;

KVOS v. Associated Press (1936), 299 U. S. 269, 81 L. Ed. 183.

The same rule is applied in testing jurisdiction where removal is sought, that is, the Courts are not bound by the pleadings.

Removal Cases (1879), 100 U. S. 457, 469, 25 L. Ed. 593, 598.

II.

The Decision Herein Is Not in Conflict With Any of the Decisions Cited by Petitioner.

None of this Court's decisions to which petitioner refers [Pet. pp. 10-11] are in conflict with the decision in the case at bar, as will appear from the following brief analysis.

The cases of *Central R.R. Co. of New Jersey v. Mills* (1884), 113 U. S. 249, 28 L. Ed. 949 and *Railroad v. Grayson* (1886), 119 U. S. 240, 30 L. Ed. 382, were not derivative suits, but involved private actions against allegedly illegal acts of the corporations themselves. Moreover, in each instance no attempt was made to go behind the pleadings.

In *Doctor v. Harrington* (1904), 196 U. S. 579, 49 L. Ed. 606 and *Venner v. Great Northern* (1907), 209 U. S. 24, 52 L. Ed. 666, the corporation involved was alleged to be under the domination or control of the officers or board of directors whose fraudulent or illegal actions the suit sought to redress, and each case was decided on the face of the pleadings. No attempt was made to show the actual facts.

The case of *City of Indianapolis v. Chase National Bank* (1941), *supra*, 314 U. S. 63, 69, 86 L. Ed. 47, 50, is one which we consider favorable to our position, and the same is true of *Koster v. Lumbermen's Mutual Gas* (1946), 330 U. S. 518, 91 L. Ed. 1067. In the former case the rule of alignment was clearly enunciated, while in the latter this Court dismissed a derivative action under the doctrine of *forum non conveniens*, but commented by way of dictum that jurisdiction in derivative stockholders' actions was saved "because the corporation is in antagonistic hands," (330 U. S. at p. 523, 91 L. Ed. at p. 1073). *A fortiori* the jurisdiction in derivative cases is *not* saved where, as here, the corporation is *not* in antagonistic hands.

The case of *Meyer v. Fleming* (1945), 327 U. S. 161, 90 L. Ed. 595, involved the disallowance of a claim in a railroad reorganization proceeding in bankruptcy. The question of diversity of citizenship or realignment was not discussed except by way of *dicta*, which is favorable to our position, this Court saying that in a derivative action the corporation "is only nominally a defendant, since any judgment obtained against the real defendant runs in its favor" (327 U. S. at p. 167, 90 L. Ed. at p. 600).

Petitioner also contends that the decision in the within case is in conflict with decisions of other Courts of Appeals, citing four cases [Pet. pp. 10-11]. Again, a brief study of these cases will show that they are not in conflict with the within decision.

Thus, in *Groel v. United Electric Co.* (C. C. N. J., 1904), 132 Fed. 252, 265, the Court in remanding the case to the State Court after it had been removed, *accepted as true* the allegations of the complaint "that the New

Jersey company is in the control of officers who are carrying out the purposes of the Pennsylvania company and its confederates, and that their position in the controversy is one of hostility to the position assumed by the complainant."

Again, in *Lavin v. Lavin* (2d Cir., 1950), 182 F. 2d 870, the Court merely affirmed a lower Court's dismissal for lack of jurisdiction on the ground that the defendant corporation should be left as a defendant, apparently on the authority of *Doctor v. Harrington, supra.* The question of hostility or antagonism or control was not mentioned.

In the case of *Schmidt v. Esquire* (7th Cir., 1954), 210 F. 2d 908, 912, the statements on the point were *dictum,* the opinion stating that it need not consider further the plaintiff's theory of alignment since the District Court had correctly ruled that, under the circumstances of the case, the citizenship of the corporation was immaterial for the purpose of testing diversity.

Lastly, in *Cutting v. Woodward* (9th Cir., 1918), 255 Fed. 633, 635, the trial court *found* that the individual defendant and the corporation had engaged in *actual fraud* while the individual defendant had virtual control of the Board of Directors and "they were ever ready to do his bidding." Further, that the defrauding individual defendant *continued* in control and hence the all-important element of an independent Board and new counsel *intervening* between the period when the wrongful acts were alleged to have occurred and the commencement of the derivative action, was there lacking.

III.

The Decision Below Was Entirely Correct on Its Facts and Is of No Particular Social or Legal Significance.

Petitioner asserts that the within decision and the decision in the case of *Smith v. Sperling* (S. D. Cal., 1953), 117 F. Supp. 781 (affirmed by the United States Court of Appeals for the Ninth Circuit, but not yet reported)* "will effectively close the doors of the federal courts to shareholders who are compelled to bring secondary or derivative actions in order to protect themselves from their own corporations, and who seek federal jurisdiction based upon diversity of citizenship" [Pet. p. 11]. This conclusion is entirely incorrect.

All the within actions does, and that quite properly, is to prevent the federal courts from being cluttered with stockholders' derivative actions which could not have been maintained in the state court in the first instance. It also prevents a claim of "diversity" where none in fact exists. However, the decision leaves open, in either the state or federal courts, a proper derivative or secondary action where the corporation is, in fact, unable to protect itself

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*We note that this Court recently granted certiorari in this case (*i.e., Smith v. Sperling*) and in the case of *Swanson v. Traer* (7th Cir., 1956), 230 F. 2d 228, each of which was a derivative action wherein a realignment of parties was made. If these petitions were granted for the purpose of re-examining the realignment rule itself, then it is probable that the Court will desire to grant certiorari in the within action, except for the sham and vexatious character of petitioner's action. If, on the other hand, certiorari was granted in the two cases just mentioned for the purpose of examining into the particular application of the realignment rule, then we submit that certiorari should not be granted in the within case since on its facts, there is no question but what realignment properly took place.

because it is under the dominance and control of the alleged wrongdoers (a situation which did not exist in the within action) and, of course, it leaves open all situations where genuine diversity exists.

IV.

The Record in the Within Case Shows That Petitioner's Action Below Was Brought in Bad Faith, Is Sham and Vexatious, and Is the Result of Petitioner's Desire to Harass the Individual Respondents Rather Than to Correct Any Alleged Wrongs to the Corporation. Hence the Facilities of This Court Should Be Denied Him.

We have already pointed out in our Statement of the Case (a) that petitioner's stock represents only 1.6% of the outstanding stock of the Corporation, (b) was purchased by him at a cost of $400.00, (c) that the Corporation is in the process of dissolution, (d) that petitioner, as well as all other stockholders, will probably receive a profit of about 75% on their shares of stock unless the Corporation's funds are dissipated in this litigation, and (e) that since the Corporation is in the process of dissolution, any recovery in this or any other litigation would be immediately distributed *pro rata* to its stockholders.

Recognizing the above situation, the individual respondents, without in any way acknowledging any liability whatsoever, but solely in an endeavor to wind up the litigation promptly and thereby save expense to the Corporation, offered to pay petitioner his pro rata share of the full amount claimed by him for the Corporation. In other words, petitioner was promptly offered the *full* amount which *he* could possibly hope to recover by this

litigation and, as previously noted, *none* of the other stockholders was interested in *any* recovery. This sensible program for disposing of litigation which is not wanted by anyone except the petitioner was rejected by petitioner's counsel as being "unrealistic" [R. 143-144]. It is patently clear, therefore, that petitioner is not interested in a recovery but solely in litigation and harassment.

Moreover, the record show that the Corporation was being governed by a new and independent Board of Directors for at least five weeks prior to the commencement of the within action. They have determined that petitioner's action was not for the best interests of the Corporation, and no claim is made that the new Board has acted in bad faith or has abused its business discretion in determining that the action should not be brought. Hence, under well settled California law, petitioner could not have even stated a cause of action in the state court. (See: *Findley v. Garrett* (1952), 109 Cal. App. 2d 166, 240 P. 2d 421.) Since diversity jurisdiction would not change such substantive rule of law, petitioner must have known that he could not state a claim in the federal courts, even if diversity were present. Again we say, petitioner is interested in litigious harassment, not justice.

Lastly, the sham and bad faith character of the "demand" which petitioner caused to be served on the respondent Ferrar on April 30, 1953, is demonstrated (1) by the fact that it was delivered only a few hours before the action was filed, and (2) by the fact that the petitioner in that demand stated that *he was filing* the Complaint in the United States District Court and he asked the corporation *to join with him* in its prosecution [R. 44-45], yet it is manifest that *such joinder would have imme-*

diately destroyed the very diversity which petitioner now purports to crave.

We submit that this Court should not, under such circumstances, place the petitioner in a position where he can further prolong his own vexatious litigation by granting his petition for certiorari in this case.

Conclusion.

The decision in the within case is not in conflict with any of the prior decisions of this Court. It follows and correctly applies the rule that Federal Courts are not bound by the pleadings in determining their jurisdiction. The trial court expressly found, after a full hearing, that the Corporation was a completely free agent prior to and at the time of the commencement of the action and, hence, that petitioner could not create diversity by the device of designating it as a defendant. Those findings were fully supported by the evidence and were properly approved by the Court of Appeals. In addition, the action was at the moment of its inception and has been at all times since, sham and vexatious.

For all of which reasons we submit that the petition for a writ of certiorari should be denied.

Respectfully submitted,

FREDERIC H. STURDY,
Attorney for Respondents John P. Lordan, Maynard Brandsma, Francis E. Browne, Robert W. Langley, Harry F. Dietrich and Ross J. Ferrar.

HENRY F. PRINCE,
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Of Counsel.

APPENDIX A.

Rule 12(h), Federal Rules of Civil Procedure.

"(h) **Waiver of Defenses.** A party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, except (1) that the defense of failure to state a claim upon which relief can be granted, the defense of failure to join an indispensable party, and the objection of failure to state a legal defense to a claim may also be made by a later pleading, if one is permitted, or by motion for judgment on the pleadings or at the trial on the merits, and except (2) that, whenever it appears by suggestion of the parties or otherwise that the court lacks jurisdiction of the subject matter, the court shall dismiss the action. The objection or defense, if made at the trial, shall be disposed of as provided in Rule 15(b) in the light of any evidence that may have been received."

Rule 52(a), Federal Rules of Civil Procedure.

"(a) **Effect.** In all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately its conclusions of law thereon and direct the entry of the appropriate judgment; and in granting or refusing interlocutory injunctions the court shall similarly set forth the findings of fact and conclusions of law which constitute the grounds of its action. Requests for findings are not necessary for purposes of review. Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the op-

portunity of the trial court to judge of the credibility of the witnesses. The findings of a master, to the extent that the court adopts them, shall be considered as the findings of the court. If an opinion or memorandum of decision is filed, it will be sufficient if the findings of fact and conclusions of law appear therein. Findings of fact and conclusions of law are unnecessary on decisions of motions under Rules 12 or 56 or any other motion except as provided in Rule 41(b)."